

TEACHERS' RETIREMENT BOARD

INVESTMENT COMMITTEE

SUBJECT: Real Estate – Affordable Housing Request
For Qualifications

ITEM NUMBER: 8

ATTACHMENT(S): 2

ACTION: X

DATE OF MEETING: July 11, 2001

INFORMATION: _____

PRESENTER(S): Mike DiRé

EXECUTIVE SUMMARY

Background

At the May, 2001 Investment Committee meeting, a motion was approved to earmark \$150 million targeted to invest in affordable housing in California. Staff was directed to develop a Request for Information (RFI) with the goal to find developers as partners for development projects. In addition, staff was directed to explore existing City, County, and State affordable housing programs and how these programs can be integrated into successful investments.

Under the Urban program approved by the board in February 2001, staff will proactively pursue urban relationships through targeting direct relationships with managers and developers. Staff will utilize this RFI to source relationships with experienced managers and developers in urban markets.

Strategy

The RFI (a draft of which is attached) will focus on sourcing firms proving successful track records in the following:

1. Investment returns within CalSTRS moderate and high risk categories (13%-20% after fees and leverage);
2. Development expertise with an affordable housing component;
3. Working relationship with city and county development authorities; and
4. Working relationship and track record with government agencies and programs related to debt and equity assistance for housing and urban development.

The attached RFI will include an introductory memo describing CalSTRS' investment portfolio and philosophy of achieving appropriate risk adjusted rates of return. Also, we will outline the goal to receive responses from developers and/or investment managers with expertise in development of affordable housing. We will encourage respondents with local as well as regional expertise as well as those with limited track record of working with institutional clients.

Upon review of the responses, staff will propose a strategy to the Investment Committee to fund developments either directly or through an advisory relationship taking into account various factors including return expectations, number of developer relationships, city/county relationships, transaction sizes, and due diligence requirements.

Timing

Staff proposes to mail the RFI on or before August 1 with responses due by September 15. Review and due diligence will follow with formation of strategy and selection of firm(s) announced at the October or November board meeting with negotiations with real estate and legal staff to follow.

Other

At its June 18 Investment Committee meeting, CalPERS approved a \$150 million allocation to affordable housing. The CalPERS Staff's plan to issue an RFP on or before August 1 with selection by September 15 was approved by the Investment Committee (item attached). CalSTRS and CalPERS real estate staffs have been in contact to ascertain if there should be a joint effort and if it would be feasible.

Conclusion

Staff feels there are affordable housing investment opportunities in California to achieve appropriate risk-adjusted rates of return. Because of the unique nature of these investments, staff recommends CalSTRS be open to strategies that include only a portion of the investment dedicated to affordable housing and/or investments that have commercial components.

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CalSTRS Request for Information
Affordable Housing Investment Program

Minimum Qualifications

1. Must qualify as a fiduciary and/or demonstrate experience managing capital for institutional investors.
2. Minimum of 3 years experience developing and/or investing in multifamily properties with an affordable housing component. Must demonstrate familiarity with and ability to underwrite federal, state, and local subsidy programs.
3. Minimum \$100 million of multifamily properties with an affordable housing component developed and/or under management for institutional clients.
4. No material litigation from investor clients.
5. Demonstrated ability to generate in a timely and accurate manner real estate performance reports consistent with AIMR and NCREIF standards.
6. The key professionals and/or the organization must not have, nor could they potentially have, a material conflict of interest with CalSTRS.

I. ORGANIZATION

A. Background

Firm Name: _____

Main Address: _____

Name: _____

Title: _____

Phone: _____

E-Mail: _____

Fax: _____

Office Locations:

H.Q. / Regional	Location	No. of Employees	Primary Function
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_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____

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B. Fiduciary Classification

_____ Bank

_____ Insurance Company

_____ Registered Investment Advisor (Investment Advisors Act of 1940). If so, provide a copy of your most recent Form ADV, Parts I & II.

_____ Affiliate of Fiduciary
(Name and Classification): _____

_____ Public Company

_____ Other/Name: _____

C. Ownership Structure

Corporation: _____ Public _____ Private _____

Partnership: _____

Joint Venture: _____

Individual: _____

Other: _____

D. Initial Operating Year: _____

E. Initial Year of Providing Services Requested by CalSTRS: _____

F. Ownership

Describe the ownership structure of your firm:

1. Provide a chart describing the ownership structure including the names of directors, if applicable, and the percentage ownership of each owner of the firm.
2. Include biographies/resumes for all directors and owners.
3. Identify affiliated or subsidiary organization(s).
4. Do investment professionals participate in equity ownership? If so, please describe equity ownership structure.
5. If equity ownership is not available, is there a specific arrangement for sharing in the profits earned by the enterprise (e.g., salary, bonus, group/individual performance incentives, profit sharing, etc.)? Please describe.

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G. Governance

1. Identify the key professional(s) responsible for day-to-day management of the firm.
2. Identify the key professional(s) responsible for strategic direction.
3. What individuals or entities control the firm:
4. Provide the voting percentage of each individual owner and/or controlling entity.

H. Lines of Business

1. List your firm's lines of business and approximate contributions of each business to your firm's total revenue.
2. If you are an affiliate or subsidiary of another company, what percentage of the firm's total revenue does your division generate?
3. Describe the organizational structure and your relationship to the parent company and any other subsidiaries, if applicable.
4. Is there any activity in which your firm, or an affiliate, acts as a general partner or similar capacity?

I. Organizational Change

1. Within the past three years, have there been any significant developments in your organization, (changes of ownership, personnel reorganization, new business ventures, etc.)? If so, please explain.
2. Do you expect any changes in the near future? If so, please explain.
3. Please indicate the turnover of professional staff your firm has had over the past five (5) years (if applicable) as follows:

Name	Position	Date Left	New Hire (yes/no)
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J. Liability Coverage

Describe the levels of coverage for fidelity bonds, errors and omission coverage and any other fiduciary insurance coverage which your firm carries, including the name of the insurance carrier, the terms of the coverage, deductible levels, exclusions, etc.

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II. FIRM HISTORY

Please provide a brief history of your firm. In addition, provide a narrative paragraph of your firm's: (i) current total assets under management nationwide including market value, number of properties, gross square footage, property types and locations; (ii) market value, number of properties, gross square footage/units of urban housing investments nationwide, locations; and (iii) market value, number of properties, gross square footage/units of urban housing in California, locations. Please include all properties developed and sold.

III. INVESTMENT STRATEGY

CalSTRS intends to engage one or more investment managers to develop, redevelop, invest and manage affordable housing properties in West Coast led by California. CalSTRS primary goal is to generate attractive risk-adjusted investment returns. An ancillary benefit is potentially alleviating the severe shortage of affordable housing in California.

A. Strategic Approach

1. What is your firm's definition of affordable housing?
2. Acknowledging that CalSTRS is a tax exempt investor, do you believe that the goal of achieving high risk adjusted rates of return is mutually exclusive with the ancillary goal or benefit of developing more affordable housing? Explain.
3. Describe any other investment structures you propose to accomplish CalSTRS' goals, including the use of investment structures such as: mezzanine financing or tax credit guarantee investing.
4. Describe the investment style you propose for CalSTRS – acquisition of existing assets, development, redevelopment, or a combination.
5. Given the current market conditions, what amount of capital could you prudently invest over a three year time frame?
6. Provide examples of investments you would pursue as part of the proposed strategy.
7. Identify markets you would target for investments for the program and describe your rationale. What experience does your firm have in these markets? How would you allocate capital among these markets?
8. Describe the tenant base you would target for properties included in the portfolio. What proportion of area median income would be served by investments you would make in the portfolio?

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9. Describe the amount and structure of leverage you would recommend for individual properties and for the portfolio.
10. Describe your research capabilities. How would research be applied in the investment and on-going asset management processes?
11. How would you source investment opportunities? How would you ensure that CalSTRS had access to the best potential investment opportunities available?
12. How have you historically sourced the proposed types of investments? What percentage of past investments have been negotiated directly versus a bid situation?
13. What other parties would be involved in investments made for the program? Describe your role vis-à-vis these other parties.
14. What role would local, State, and Federal governments play in the investment program? Would government funds be used in conjunction with CalSTRS funds in investments you would make for the program?
15. Describe your investment due diligence process.
16. Describe your firm's competitive advantage. Why should your firm be selected as an investment manager of a CalSTRS affordable housing investment program?
17. How much uncommitted capital does your firm have today for strategies similar to that proposed by CalSTRS? For how many clients?

B. Exit Strategies

1. What is your anticipated average holding period for each investment?
2. What is the internal review and approval process for determining a disposition candidate? What market indicators do you use to determine when to sell an asset? How often are your market indicators updated?
3. What are the primary exit strategies for the investments you plan to make? Have you effectively implemented these strategies in the past? If so, please provide a brief description of the specific deals and exit strategies achieved. Describe the factors that limit exit strategies, if any.

C. Projected Returns

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1. Present a proforma property and portfolio return spreadsheet for a \$50 million equity investment account for one and five year periods. Detail cash flow and IRR return expectations. Return projections should be unleveraged, before investment management fees. If you propose leveraged investments, include projections for leveraged returns.
2. How do you propose to benchmark program returns?
3. Identify risks that would be incurred in implementing your proposed strategy and discuss mitigation techniques to result in minimizing risk. Compare the risks to be undertaken and returns anticipated from your proposed program to traditional core real estate investing. Is the return appropriate to the risks taken?

IV. MANAGEMENT TEAM

1. List the individuals of the management team who would be involved in the CalSTRS program and the percentage of time each person would allocate to the CalSTRS account. Include resumes for each.
2. Briefly describe how your management team is uniquely qualified to achieve CalSTRS' objectives in an affordable housing program. Illustrate the investing, development and/or operating expertise possessed by the members of the proposed team.
3. In the event your firm is selected, to what degree if any would you need to increase your staff? Please explain.

V. TRACK RECORD

1. Describe your firm's experience in acquiring, developing, managing, and disposing of multifamily properties with an affordable housing component.
2. Provide a descriptive table of information for each affordable housing investment your firm has made, including: property description, location, initial investment date, investment structure, property capitalization detail including amount provided by all involved capital sources, leverage amount, disposition date (if applicable), IRR (actual or projected if investment not yet sold).
3. Provide one-year, five-year, and since-inception nominal returns for each affordable housing investment your firm has made. If leveraged, also provide the amount of leverage and an unleveraged return.
4. Describe in detail your firm's experience with federal, state, county and city programs designed to encourage production of affordable housing properties. Please provide examples of specific projects.

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VI. ALIGNMENT OF INTERESTS

How would you structure a relationship to align interests between CalSTRS and your firm?

VII. REFERENCES

List five references including the organization name, contact person, address, telephone number, type of relationship and length of relationship. At least two of the references must be institutional investors.



Investment Office – Real Estate
Post Office Box 2749
Sacramento, CA 95812-2749
(916) 326-3240
(916) 326-3400 (fax)

June 18, 2001

AGENDA ITEM 4c

TO: MEMBERS OF THE INVESTMENT COMMITTEE

- I. SUBJECT:** Affordable Housing Proposal
- II. PROGRAM:** Real Estate – Specialized Portfolio
- III. RECOMMENDATION:** Approval of the following:
 - a. Establishment of an Affordable Multi-Family Housing Program
 - b. Focused solicitation process for the selection of two Partners/Advisors
 - c. Allocation of \$150 million

IV. ANALYSIS:

Background

The System currently invests in the affordable housing sector through a variety of partnerships, and funds, but does not have an affordable housing program that is focused exclusively on providing equity for multi-family affordable housing. One of the strategies of the Specialized Real Estate Portfolio is to invest in affordable housing. This type of program has also been proposed in the State Controller's letter to Mr. Flaherman dated February 2, 2001, (Attachment 1) and amended in the letter to Mr. McCook dated May 18, 2001. (Attachment 2)

Currently CalPERS has contracts with Commonwealth Pacific (CWP), CIM Urban Real Estate Fund (CIM), California Urban Investment Partners (CUIP), Bridge Housing, Calsmart (Rreef), and Kennedy Associates. In addition, the Investment Committee under the CUREI program will consider another four firms at the June 2001 meeting. Each of these firms, in accordance with their approved strategy, fund pre-development capital, construction financing, mezzanine debt, and/or equity-gap financing to develop office, mixed-use and residential development in California.

In total the CUREI program provides for \$1.025 billion for in-fill development. In addition the Single Family Housing Program, with another seven Partners, provides \$1.02 billion specifically for housing. Approximately 5,000 homes that CalPERS is currently building are priced at the entry-level.

The following are examples of CalPERS' investment in the affordable housing market that includes for-sale housing and rental units:

- Through the World/Bridge CalPERS initiative, CalPERS has funded over \$36 million in construction debt to build approximately 1500 affordable units in California.
- Commonwealth Pacific structured short-term equity investment in the amount of \$6.4 million with Capital Vision Equities to build and rehab 362 low income rental housing. Three of the projects are in Los Angeles and one is in Oakland.
- The California Community Mortgage Fund has provided long-term debt in the amount of \$45 million for 1,487 units, with another \$8 million for 279 units in the pipeline.
- In the AFL-CIO Housing Investment Trust program, CalPERS has funded \$30 million on nine low-income multi-family projects in California.
- Through the Housing Program Wells Fargo has funded \$429 million representing over 2,100 homes of Community Reinvestment Act qualifying commitments.
- CalPERS and Wells Fargo funded approximately \$10 million of entity level financing for the Olson Company. The Olson Company is a nationally recognized firm whose sole strategy is urban in-fill development, primarily for-sale housing. A private/public partnership is utilized to bring each project through entitlement to completion. Approximately 50% of the projects are on land owned by local government. Most of their projects are in the Los Angeles area.
- All of the Housing Partners have certain projects that require a set-aside of homes and lots for affordable housing.
- GID and SSR, the System's multi-family Partners, each have projects that have set-aside units for low and moderate-income residents. SSR currently has 114 units in three projects in California.

Recommendation

Staff recommends that the Investment Committee approve an affordable housing program specifically focused on providing equity for multi-family affordable units, including projects with 70/30 and 80/20 market-rate unit to affordable unit ratios. Some of the features of the program will include an Internal Rate of Return (IRR) to be in the minimum range of 13-15% leveraged after fees, using a maximum of 60% leverage. Staff recommends that the alignment of interest require a capital investment by the Partner/Advisor and performance based incentive fees.

In addition, Staff recommends that a focused solicitation be initiated by August 1, 2001, with responses due by September 15, 2001. Interviews will be completed by October 15, 2001, with a recommendation(s) to the Investment Committee at the November 13, 2001 meeting. We also recommend that a representative from the Investment Committee participate in the interviews.

Staff recommends that two Partners be selected for this program that will source, underwrite and fund the transactions to developers. If a developer is chosen, we propose using an existing Partner to oversee the transactions.

V. STRATEGIC PLAN:

This item is consistent with the Strategic Plan, Goal IV, which seeks to assure that sufficient funds are available, first to pay benefits and, second, to minimize and stabilize employer contributions.

VI. RESULTS/COSTS:

Staff proposes an allocation of \$150 million for the program, with each Partner receiving an initial allocation of \$60 million. A reserve of \$30 million will be set aside in the event a development partner requires additional funds. The SIO, at its discretion, will award the additional capital to a partner(s) based on portfolio performance per the program guidelines.

Bryan Bailey
Investment Officer

Michael McCook
Senior Investment Officer

Dan Szente
Chief Investment Officer



KATHLEEN CONNELL
Controller of the State of California

February 2, 2001

Mr. Michael Flaherman
Chairperson, CalPERS Investment Committee
BART
800 Madison St., MSQ - 3
Oakland, CA 94607

Dear Mr. Flaherman:

One of the components of the Specialized Real Estate Portfolio, including the California Urban Real Estate Initiative, is to invest in affordable housing.

Recent media reports have documented the critical need for housing in urban localities and I feel that the current efforts under this portfolio will not allow CalPERS to take advantage of this opportunity.

I have developed a proposal that I feel will allow CalPERS to increase its investment in this market by meeting a specific need that will benefit all of the residents of the urban areas in which investments will be made. It will allow CalPERS to partner with local government in this effort and would include assistance from various state boards on which I am a member.

I have attached a copy of this proposal and am requesting that the Investment Committee direct staff to research this proposal and develop a specific recommendation for inclusion within the Specialized Real Estate Portfolio. My staff will be made available to work with them as needed.

Sincerely,

KATHLEEN CONNELL
State Controller

- ☐ SACRAMENTO 300 Capitol Mall, Suite 1850, Sacramento, CA 95814 (916) 445-2636
☐ Mailing Address: P.O. Box 942850, Sacramento, CA 94250
☐ LOS ANGELES 600 Corporate Pointe, Suite 1150, Culver City, CA 90230 (310) 342-5678

Concept for Affordable Housing Program via PERS/STRS Capital Investment

Local Government Housing Fund: General Concept

Use PERS and/or STRS money to provide much needed capital investment for affordable housing, utilizing local governments as a partner. The program would work as follows: PERS/STRS would designate an amount of funding to be invested in housing. They would then issue an RFP to local governments (city/county). Each proposal would compete based on its ability to accomplish the following goals:

- 1) Create the greatest number of affordable units. Acceptable projects could include mixed-use and mixed-income projects. The proposals that can create the greatest number of affordable units within the constraints imposed will be the most competitive;
- 2) Greatest leverage from amount received. Each government entity should demonstrate its ability to leverage any funds received into the maximum benefit for housing construction;
- 3) Expedited processing for developments: Proposal should include a program for expediting review and approval of developments. The money saved by expediting developments will lower costs and increase returns;
- 4) Acceptable rate of return; PERS/STRS would realize a 15% return.

CDLAC/TCAC

In order to augment the amount of financing available, we will also propose changes to the CDLAC and CTAC procedures such that projects financed through the PERS/STRS Local Government Housing Fund would receive additional points on their CDLAC/TCAC application.

Model

Bridge Housing Model: \$100 million in equity partnership for acquisition as part of long-term investment program; Capital will recycle.

Potential Benefit

If this program served as an incentive to expedite the various processes that are required to begin a project, the cost savings that could be realized would be significant. Currently, approval processes can take anywhere from 3 months to several years. As approval processes drag on, developers incur carrying costs such as interest payments and penalties. If the average approval process time were to be condensed to 3 months, the cost reduction could be 5% - 10% or greater. Partnership with local government would also reduce uncertainty as to whether the project would succeed, thereby reducing costs further.

Additional Notes

- As affordable housing tends to be a lower-return investment, this program would likely encourage mixed-use and mixed income developments.
- Developments would be subject to all local housing program regulations and obligations. These regulations often call for developers to meet certain minimum levels of services, facilities, management on site that often discourage for-profit developers from using local subsidies. However, the program will create a positive incentive to streamline those regulations.
- The procedures for this program would also need to be constructed so as not to discriminate against metropolitan areas with higher costs such as San Francisco and Los Angeles.

Staff should address, at minimum, unresolved questions such as these:

- What would the interest level of local governments be in such a program?
- Can cities/counties create a program that would generate the kind of return that would be required by PERS/STRS? What would that return need to be, at minimum?
- How much funding would be available from PERS/STRS?
- Is the Bridge Housing model applicable? What other models are applicable?
- What is the overall time frame for this program (concept to implementation)?
- Financing particulars: Equity partnership or loan, etc.?



KATHLEEN CONNELL

Controller of the State of California

May 18, 2001

Michael McCook
Real Estate Director
CalPERS
400 P. Street, Room 3492
Sacramento, CA 95814

Dear Mr. McCook:

I appreciated the opportunity to further define my proposal for a Local Government Affordable Housing Program. Please consider the following in your evaluation:

- 1) Funding will be for multi-family affordable units, with 70/30 or 80/20 as the preferred configurations of market rate to affordable units;
- 2) Investments should provide a 12% - 15% leveraged return after fee, allowing 60% leverage;
- 3) Investments should be made directly with developers who have a demonstrated affiliation with local governments that can be expected to lead to expedited construction;
- 4) A limited number of developers should be selected through a focused Request for Qualifications/Request of Information process; and
- 5) CalPERS staff should initially manage this program. If the program is later expanded, CalPERS may consider using an advisor.

You may wish to consult with Chris Ailman, Chief Investment Officer of CalSTRS regarding the details of their implementation of this program to determine the possibility of any joint efforts.

If you have additional questions, please contact Walter Barnes, Chief Deputy Controller, Finance, at 445-2636.

Sincerely,

Kathleen Connell
State Controller

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